

Message Text

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ACTION ARA-14

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-05 H-01 INR-10

L-03 NSAE-00 NSC-05 PA-01 SP-02 SS-15 ICA-11

AID-05 COME-00 EB-08 FRB-03 TRSE-00 XMB-02

OPIC-03 LAB-04 SIL-01 OMB-01 AGRE-00 INT-05 OES-07

DOE-15 SOE-02 /124 W

-----060772 101745Z /42

R 101418Z MAY 78

FM AMEMBASSY BUENOS AIRES

TO SECSTATE WASHDC 5662

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E.O. 11652: N/A

TAGS: EFIN, ELAB, ECON, AR

SUBJECT: ARGENTINA: STAGFLATION DILEMMA

1. SUMMARY: ON MAY 9, THE MEDIA CARRIED ECONOMIC NEWS RELEASED BY THE GOVERNMENT ON INFLATION, ECONOMIC GROWTH, AND SALARIES. OVERALL, THE NEWS WAS BAD. INFLATION IS PROCEEDING AT A HIGHER PACE THAN LAST YEAR; GDP DROPPED SHARPLY IN THE FIRST QUARTER OF 1978 AND PARTICULARLY MANUFACTURING ACTIVITY; AND THE WAGES WHICH WERE ADJUSTED OF GOVERNMENT EMPLOYEES BY ALMOST THE SAME PERCENTAGE AS THE INFLATION, DID NOT MAKE UP FOR LOSS IN REAL WAGE INCOME SINCE THE LAST ADJUSTMENT. THE MINISTER OF ECONOMY WILL ADDRESS THE NATION MAY 11 TO REVIEW THE CURRENT ECONOMIC CRISIS AND TO ANNOUNCE A NEW PRESCRIPTION TO COMBAT INFLATION. WHATEVER NEW MEASURES ARE ADOPTED, THE GOA WILL BE FORTUNATE TO KEEP THE CPI INCREASE IN 1978 DOWN TO 120 PERCENT. AT THE SAME TIME, GDP FOR THE FULL YEAR IS UNLIKELY TO SHOW ANY GROWTH. THE ADVERSE ECONOMIC SITUATION HAS INCREASED PRESSURES FOR MARTINEZ DE HOZ'S OUSTER.

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HOWEVER, MARTINEZ DE HOZ

HAS IN THE PAST BEEN ABLE TO WITHSTAND SUCH

PRESSURES THROUGH THE SUPPORT OF PRES. VIDELA.

MOREOVER, THE GOVERNMENT'S DESIRE TO PROJECT AN IMAGE

OF STABILITY IS ANOTHER FACTOR MITIGATING AGAINST HIS

REMOVAL IN THE NEAR FUTURE.

2. INFLATION:

--(A) THE CONSUMER PRICE INDEX IN APRIL ROSE 11.1 PERCENT, BRINGING THE TOTAL INCREASE FOR THE FIRST FOUR MONTHS OF 1978 TO 46.4 PERCENT -- SUBSTANTIALLY HIGHER THAN THE 33.3 PERCENT RISE IN THE INDEX DURING THE SAME PERIOD IN 1977. THE CPI HAS GONE UP 186.0 PERCENT DURING THE PAST 12 MONTHS -- 25.6 PERCENT MORE THAN THE CPI INCREASE FOR FULL YEAR 1977. DURING APRIL, THE MAIN CATEGORIES OF THE CPI REGISTERED THE FOLLOWING UPWARD PERCENTAGE CHANGES: FOOD AND BEVERAGES - 12.5; CLOTHING - 17.3; HOUSING, FUEL, AND ELECTRICITY - 8.7; HOUSEHOLD FURNISHINGS AND OPERATIONS - 9.9; MEDICAL CARE - 9.2; TRANSPORTATION AND COMMUNICATIONS - 8.6; RECREATION AND EDUCATION - 6.0; AND MISCELLANEOUS - 10.8.

--(B) THE WHOLESALE PRICE INDEX (WPI) IN APRIL ROSE 9.1 PERCENT, BRINGING THE TOTAL INCREASE FOR THE FIRST FOUR MONTHS OF 1978 TO 38.0 PERCENT -- ALSO SIGNIFICANTLY GREATER THAN THE 26.5 PERCENT RISE DURING THE SAME PERIOD LAST YEAR. THE WPI HAS GONE UP 154.9 PERCENT DURING THE PAST 12 MONTHS.

3. NATIONAL ACCOUNTS:

GDP DURING THE FIRST QUARTER OF 1978 DECLINED BY 7.2
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PERCENT IN RELATION TO THE SAME PERIOD IN 1977. SECTORS SHOWING DECLINES PREDOMINATED AS FOLLOWS: MANUFACTURING (-11.5 PERCENT); AGRICULTURE (-7.0 PERCENT); MINING (-1.6 PERCENT); ELECTRICITY, GAS, AND WATER (-0.7 PERCENT); COMMERCE (-7.3 PERCENT); TRANSPORTATION, STORAGE, AND COMMUNICATIONS (-4.6 PERCENT); AND COMMUNITY, SOCIAL, AND PERSONAL SERVICES (-6.9 PERCENT). THE ONLY SECTORS SHOWING GROWTH WERE: CONSTRUCTION (UP 9.2 PERCENT); AND BANKING, INSURANCE, AND REAL ESTATE (UP 1.5 PERCENT). GROSS FIXED INVESTMENT AND CONSUMPTION DECLINED 16.6 PERCENT AND 2.4 PERCENT RESPECTIVELY.

4. SALARY ADJUSTMENTS FOR GOVERNMENT EMPLOYEES: EFFECTIVE MAY 1, THE SALARIES OF GOVERNMENT EMPLOYEES WERE INCREASED BY 50.4 PERCENT AT THE TOP LEVEL (CATEGORY 24 NOW MAKES ROUGHLY 854/MONTH) AND BY 44.9 PERCENT AT THE BOTTOM (CATEGORY 1 NOW MAKES ROUGHLY \$92/MONTH). SALARY INCREASES FOR THE INTERMEDIATE CIVIL SERVICE CATEGORIES WERE BETWEEN THESE TWO EXTREMES. THE NEW SALARIES OF CERTAIN SUPERGRADE OFFICIALS WERE ALSO REVEALED -- E.G. PRESIDENTS OF CNEA, ENTEL,

ENCOTEL, AEROLINEAS, GAS DEL ESTADO, ETC.,
NOW MAKE AROUND \$1200/MONTH.

5. COMMENT: IT IS CLEAR THAT THE ECONOMIC POLICIES
OF THE GOA ARE IN SERIOUS TROUBLE. THE GOVERNMENT HAS
SUCCEEDED IN REDUCING THE LEVEL OF FISCAL DEFICIT,
DECELERATING THE GROWTH OF MONETARY AGGREGATES, AND
IN CURBING ECONOMIC ACTIVITY WHICH MIGHT PUT A PRESSURE
ON RESOURCES -- ACCOMPLISHMENTS WHICH UNDER NORMAL
CIRCUMSTANCES WOULD BE EXPECTED TO LEAD TO LOWER
INFLATION. INSTEAD, ARGENTINA IS SUFFERING SEVERE
STAGFLATION, WITH A DISAPPINTING RISE IN INFLATION AND
A SHARP DOWNTURN IN ECONOMIC GROWTH.

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6. IN CONTRAST WITH THE ADVERSE RESULTS IN MARCH, THE
DOUBLE DIGIT INFLATION RATE FOR APRIL WAS EXPECTED AND
COMMENTED ON EXTENSIVELY IN THE PRESS - A TYPE OF
SPECULATION NOT APT TO CURB THE PREVAILING INFLATIONARY
PSYCHOLOGY. MINISTER OF ECONOMY MARTINEZ DE HOZ AND
HIS ECONOMIC TEAM MET AT LENGTH TO TRY TO DEVELOP A
NEW STABILIZATION STRATEGY TO COMBAT INFLATION. MARTINEZ
DE HOZ IS SCHEDULED TO ANNOUNCE THE STRATEGY IN A BROAD-
CAST TO THE NATION ON MAY 11. THUS FAR, DETAILS OF
THE STRATEGY HAVE BEEN TIGHTLY HELD BUT IT IS SPECULATED
THAT "DE-INDEXATION" OF ADJUSTMENTS OF PUBLIC SERVICE

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R 101418Z MAY 78
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RATES AND FUEL PRICES WILL BE ONE OF THE PRINCIPAL MEASURES TO BE TAKEN BY THE GOVERNMENT. IN ESSENCE, THIS MEANS THAT THE GOVERNMENT WILL TRY TO LENGTHEN THE PERIOD BETWEEN RATE ADJUSTMENTS OF PUBLIC SERVICES AND TO BASE THE ADJUSTMENTS MORE ON ACTUAL INCREASES IN THE COSTS OF UTILITIES RATHER THAN ON INFLATIONARY TRENDS. AS EXPLAINED BY SECRETARY OF TREASURY JUAN ALEMANN, THE ADJUSTMENTS OF PUBLIC SERVICES ARE FREQUENTLY USED BY THE PRIVATE SECTOR AS INDICATORS FOR RAISING THEIR OWN PRICES -- A SELF-PERPETUATING PROCESS FUELING INFLATION. TO BE EFFECTIVE, HOWEVER, THE DE-INDEXATION PLAN WILL HAVE TO BE ACCOMPANIED BY MEASURES TO CUT DOWN COSTS (AND PROBABLY PERSONNEL) IN THE NOTORIOUSLY INEFFICIENT STATE ENTERPRISES. OTHERWISE, THE TREASURY MIGHT HAVE TO RESORT TO CENTRAL BANK CREDIT ONCE AGAIN TO MAKE UP FOR THE SHORTFALLS IN THE REVENUES OF STATE ENTERPRISES -- A RESULT WHICH IN ITSELF IS INFLATIONARY. OTHER POSSIBLE STABILIZATION MEASURES WERE DISCUSSED BRIEFLY BY MARTINEZ DE HOZ IN HIS COMMENTS ON THE MARCH INFLATION RESULTS (SEE BA 2861). WHATEVER THE FINAL PACKAGE LOOKS LIKE, HOWEVER, IT NOW APPEARS THAT THE GOA WILL BE LUCKY IF

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IT CAN LIMIT INFLATION TO 120 PERCENT FOR FULL-YEAR 1978.

7. THE GDP RESULTS FOR THE FIRST QUARTER OF 1978 WERE ALSO VERY DISAPPOINTING, PARTICULARLY SINCE THE BASE OF COMPARISON WAS THE POOR FIRST QUARTER OF 1977. ALTHOUGH ECONOMIC ACTIVITY TURNED UPWARD IN THE SECOND QUARTER AS EXPECTED, BUSINESS IS STILL SLUGGISH. WITH THE FISCAL DRAG EXPECTED TO INCREASE IN THE SECOND HALF OF 1978, AND THE 1977 BASE OF COMPARISON FOR THE THIRD QUARTER PARTICULARLY HIGH, IT NOW SEEMS UNLIKELY THAT THERE WILL BE ANY GDP GROWTH FOR FULL YEAR 1977.

8. BY AND LARGE, THE SALARY ADJUSTMENTS FOR GOVERNMENT EMPLOYEES WERE JUST ABOUT EQUAL TO THE RISE IN CPI SINCE THE LAST PAY RAISE JANUARY 1; THOSE AT THE BOTTOM OF THE SALARY SCALE WERE SLIGHTLY WORSE OFF AN THOSE AT THE TOP SLIGHTLY BETTER OFF. THE GOVERNMENT, HOWEVER, DID NOT MEET ITS PREVIOUSLY ANNOUNCED TARGET OF RAISING EVERYONE'S WAGES 5 TO 9 PERCENT IN REAL TERMS EVERY FOUR MONTHS, WITH A TOTAL INCREASE OF 50 TO 100 PERCENT OVER A PERIOD OF THREE YEARS. MOREOVER, THE

SALARY RAISE DID NOT MAKE UP FOR THE LOSS IN REAL WAGES
BETWEEN ADJUSTMENTS. ADDING TO THE GOVERNMENT'S DILEMMA,
THE LARGE NOMINAL ADJUSTMENT OF GOVERNMENT SALARIES
SHOULD FEED INFLATION IN MAY.

9. THE ADVERSE ECONOMIC NEWS HAS UNDOUBTEDLY INCREASED
PRESSURES FOR MARTINEZ DE HOZ'S OUSTER. HOWEVER,
IN THE PAST THE MINISTER HAS BEEN ABLE
TO WITHSTAND SUCH PRESSURES THROUGH
THE CRUCIAL SUPPORT OF PRESIDENT VIDELA. MOREOVER,
THE GOVERNMENT'S DESIRE TO PROJECT AN IMAGE OF STABILITY --
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A DESIRE WHICH REPORTEDLY ACCELERATED THE DECISION
ON THE FOURTH MAN -- IS ANOTHER FACTOR MITIGATING
AGAINST HIS REMOVAL IN THE NEAR FUTURE. MARTINEZ
DE HOZ, IN TURN, HAS ANNOUNCED PUBLICLY THAT HE PLANS
TO KEEP HIS ECONOMIC TEAM INTACT AND THAT NO SACRIFICIAL
LAMBS WILL BE OFFERED TO APPEASE THE CRITICS.
CASTRO

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